

# NOTICE AS CONDITION PRECEDENT TO CLAIM LIQUIDATED ASCERTAINED DAMAGES (LAD)

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## **ABSTRACT**

Most forms of building contract include a clause entitling the employer to a specified amount of damages, referred to as liquidated and ascertained damages (LAD) if the contractor is late in constructing a project. This clause sets out the procedure and condition that need to be followed by the employer. Some provision for example in clause 40.1 PWD 203A (Rev. 2007) require the employer to issue notice of intention before claiming LAD. The purpose of the issuance of notice is to inform the contractor about the payment or deduction. However, does the issuance of notice is condition precedent to the said claim? Some provision does not specifically expressly state the requirement to issue notice. So, there is an argument that section 56(3) of Contract Act is effective as an implied term to the contract. Based on the respective situations, question arises whether the employer's entitlement to liquidated damages is waived if he fails to issue the said notice. This study is carried out to determine whether notice is condition precedent to claim liquidated damages and the legal impact of notice provision for liquidated damages claim. The study was carried out mainly through documentary analysis of law journals. It was found that when the provision expressly state that notice is condition precedent, the failure to comply with notice provision might jeopardize the employer's claim. However, the employer's claim is not totally rejected because based on prevention principle, the contractor who caused the delay, cannot benefit from its wrong act. When the provision did not expressly state that notice is a condition precedent, it can be condition precedent by implication. The argument that section 56(3) is an implied term to the contract was wrong because section 56(3) is only applicable when the contract becomes voidable.

## ABSTRAK

Kebanyakan borang kontrak pembinaan mengandungi klausa bagi membolehkan majikan menuntut ganti rugi jika kontraktor tidak menyiapkan kerja pada tarikh siap yang ditetapkan yang dikenali sebagai Ganti Rugi Tertentu dan Ganti Rugi Ditetapkan. Klausa ini mengandungi prosedur dan syarat yang perlu diikuti oleh pihak yang berkontrak. Terdapat sesetengah klausa yang menyatakan bahawa majikan perlu mengeluarkan notis niat sebelum memohon ganti rugi seperti yang dinyatakan di dalam klause 40.1 JKR 203A (Sem. 2007). Tujuan pengeluaran notis adalah untuk memaklumkan kepada kontraktor mengenai pembayaran atau pemotongan yang akan berlaku. Namun, adakah pengeluaran notis menjadi syarat yang perlu dipenuhi sebelum membuat tuntutan tersebut? Sesetengah klausa tidak menyatakan keperluan untuk mengeluarkan notis niat sebelum menuntut ganti rugi. Oleh itu, terdapat pendapat mengatakan seksyen 56(3) Akta Kontrak 1950 akan bertindak sebagai syarat tersirat kepada kontrak mereka. Berdasarkan situasi yang dinyatakan di atas, persoalan timbul sama ada hak majikan terhadap ganti rugi akan terjejas jika dia gagal mengeluarkan notis. Kajian dijalankan untuk mengetahui sama ada notis menjadi syarat sebelum menuntut ganti rugi dan kesan peruntukan notis tersebut dari sudut undang-undang. Kajian telah dijalankan dengan menjalankan analisis dokumentari jurnal undang-undang. Hasil kajian mendapati apabila klausa menyatakan notis menjadi syarat sebelum memohon ganti rugi, kegagalan untuk mematuhi syarat tersebut akan menjejaskan hak majikan terhadap ganti rugi tersebut. Namun, majikan masih layak untuk menerima pampasan kerana berdasarkan prinsip pengelakan, kontraktor tidak boleh mendapat keuntungan daripada kesalahannya sendiri. Pendapat yang menyatakan seksyen 56(3) adalah syarat tersirat kepada kontrak adalah salah kerana seksyen 56(3) hanya boleh terpakai apabila kontrak tersebut menjadi kontrak yang boleh dielakkan.

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## LIST OF ABBREVIATION

All ER -	All England Law Report
BLR -	Building Law Report
CIDB -	Construction Industry Development Board
EWHC-	High Court of England and Wales
EXCH -	Law Reports: Court of Exchequer
FIDIC -	Federation Internationale des Ingenieurs-Conseils
IEM -	The Institute of Engineers, Malaysia
LAD -	Liquidated and Ascertained Damages
MLJ -	Malayan Law Journal
MLJU -	Malayan Law Journal Unreported
PAM -	Pertubuhan Arkitek Malaysia
PWD -	Public Work Department
JCT -	Joint Contracts Tribunal

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## CHAPTER 1

### INTRODUCTION

#### 1.1 Background of the Study

A contract is an agreement between two or more parties which creates obligations to do or not do the specific things that are the subject of that agreement and it is enforceable by law.<sup>1</sup> If one of the parties failed to perform his part of the obligation or he does it not according to the contract, he is considered to be in breach of the contract.<sup>2</sup> It now gives the other party the right to claim for damages for the breach. Damages are normally assessed when breach occurs, and are designed to be compensatory in nature.<sup>3</sup> Two principles important for assessment of damages are the principles of remoteness derived from the famous case of *Hadley v Baxendale*<sup>4</sup> in which Baron Alderson said:

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<sup>1</sup> Section 2 of Contracts Act 1950

<sup>2</sup> Beatson J. (2002). *Anson's Law of Contract*. (28th ed.). United States: Oxford University Press. p.172

<sup>3</sup> Molloy J. B., (2001). *Liquidated Damages – Some General Principles*. HKIS Newsletter, 4 May p.1

<sup>4</sup> (1854) 9 EX 341

*"Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e. according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it".<sup>5</sup>*

The measures of damages are derived from the equally old case of *Robinson v Harman*<sup>6</sup> where it was stated:

*"The rule of common law is that where a party sustains a loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed".<sup>7</sup>*

Damages calculated from these principles are normally assessed after the breach occurs and are known as general or unliquidated damages. However, such approach is difficult to assess and usually the contracting parties like certainty.<sup>8</sup> This lead party to include within their contracts remedies for most common breaches which are known as liquidated damages.

Liquidated damages or usually known as liquidated and ascertained damages (LAD) arise where the parties to a contract agree from the start the amount of damages that one party will pay to the other in the event of a specified breach of contract.<sup>9</sup> In England, the imposition of the word "ascertained" is aim to put a distinction between "liquidated damages" with "penalty" where this word will lend

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<sup>5</sup> Molloy J. B., (2001). *Liquidated Damages – Some General Principles*. HKIS Newsletter, 4 May p.1

<sup>6</sup> (1848) 1 EXCH 850

<sup>7</sup> Molloy J. B., (2001). *Liquidated Damages – Some General Principles*. HKIS Newsletter, 4 May p.1

<sup>8</sup> *Ibid.*

<sup>9</sup> Murdoch J. (2009). *Being Late Can Have Damaging Effects*. The Estates Gazette. ProQuest Direct.

more weight to the argument that the liquidated damages is a genuine and ascertained pre-estimate of the Employer's loss. However in Malaysia, there is no such distinction between liquidated damages and penalty.<sup>10</sup>

Most forms of building contract include a clause entitling the client to a specified amount of damages, referred to as "Liquidated Damages" or "Liquidated and Ascertained Damages" (LAD) if the Contractor is late in handing over the building.<sup>11</sup> LAD replaces the client's common law right to damages for late completion with a contractual right to a pre-determined sum for the period of delay.<sup>12</sup> These clauses are favoured by employers because they alleviate the need to prove an actual loss. However, this did not apply in Malaysia, because the client still need to prove the actual damages suffered pursuant to section 75 of the Contract Act 1950.<sup>13</sup> The imposition of LAD is also purport to provide for a negotiated and fair method of allowing for the possibility of a delay in completion of the project, which provides adequate compensation for the purchaser/owner, while ensuring that the contractor is not too heavily penalized for the delay.<sup>14</sup>

One of the issues that can be discussed is regarding the issuance of notice of intention before claiming liquidated damages. If the contract clearly stated that the employer should issue notice of intention to claim liquidated damages, does it invalidate the employer's right to deduct payment if he fail to issue them? Does the issuance of certificate of non-completion is enough to entitle the employer to claim LAD? For example in section 40 P.W.D. Form 203A (Rev. 2007):

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<sup>10</sup> *SS Maniam v. State of Perak* [1957] MLJ 75

<sup>11</sup> Clause 40.1 PWD 203A (Rev. 2007), Clause 22.1 PAM 2006, Clause 26.2 CIDB (2000 Edition)

<sup>12</sup> Turner B., 2011. *Liquidated damages clauses in construction contracts*. [online] Available at: <http://www.boysturner.com/news-article.html?id=66> [Accessed 22 January 2011].

<sup>13</sup> Lim C. F. (1993). Enforcement of Liquidated Damages- To Prove Actual Loss?. *The Malayan Law Journal Articles*. Vol 1, 1-9. Lexis Nexis Business Solution.

<sup>14</sup> PM Professional Resources (2010). *Construction Claim and Dispute Resolution*. [online] Available at: <http://www.pm-pro.com.my/> [Accessed 20 October 2010].

*If the Contractor fails to complete the Works by the Date for Completion or within any extended time granted pursuant to clause 43 (Delay and Extension of Time), the S.O. shall issue a Certificate of Non-completion to the Contractor. Prior to the issuance of the Certificate of Non-completion, **the S.O. shall issue a notice** to the Contractor informing the Contractor the intention of the Government to impose Liquidated and Ascertained Damages to the Contractor if the Contractor fails to complete the Works by the Date for Completion or within any extended time granted.*

The clause stated that prior to the issuance of the Certificate of Non-completion the Superintending Officer shall issue a notice to the contractor informing the intention of the government to impose Liquidated and Ascertained Damages. However, does the issuance of notice is considered “condition precedent” or just information. If it is considered as condition precedent, does it waive the employer’s right to claim liquidated damages if the employer fail issue the notice?

In *A.Bell & Son (Paddington) Ltd v CBF Residential Care & Housing Association*<sup>15</sup> Judge John Newey QC state that the certificate of failure to complete and a written requirement of payment or allowance under the middle part of clause 24.2.1 (JCT 98) were conditions precedent to the making of deductions on account of liquidated damages. In *Holloway Holdings Ltd v Archway Business Centre Ltd*<sup>16</sup> a similar clause in IFC 84 was considered and it was again held that for the employer to be able to deduct liquidated damages there must both be a certificate from the Architect and a written request to the contractor from the employer.<sup>17</sup>

On another issue, for example in PWD 203A (Rev. 10/83), it did not mention the requirement to give written notice of intention to claim liquidated damages. Below is the example of the clause:

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<sup>15</sup> [1990] 46 BLR 102

<sup>16</sup> 19 August 1991, unreported

<sup>17</sup> Chappell D. (2007). *The JCT Design and Build Contract 2005*. (3<sup>rd</sup> ed.). Oxford:Wiley-Blackwell.

Clause 40 Damages for Non-completion (PWD 203A (Rev. 10/83))

*If the Contractor fails to complete the Works by the “Date for Completion” stated in the Appendix or within any extended time under Clause 43 hereof and the S.O. certifies in writing that in his opinion the same ought reasonably so to have been completed the Contractor shall pay or allow the Government a sum calculated at the rate stated in the Appendix as Liquidated and Ascertained Damages for the period during which the said Works shall so remain and have remained incomplete and the S.O. may deduct such damages from any monies due to the Contractor. The certificate issued under this Condition shall be referred to as the “Certificate of Non-completion”.*

The clause entitled the employer to claim for damages for late completion of the project. From the clause above, there is no requirement for the employer to issue notice of intention to claim liquidated damages. If such situation occurs, can the contractor argue that the employer must issue notice as mention under section 56(3) of the Contract Act? Does section 56(3) of the Contract Act is an implied term to contract between parties?

In Section 56 (3) of Contract Act 1950 states:

*If, in case of a contract voidable on account of the promisor’s failure to perform his promise at the time agreed, the promisee accepts performance of the promise at any time other than that agreed, **the promisee cannot claim compensation for any loss occasioned by the non-performance of the promise at the time agreed, unless, at the time of the acceptance, he gives notice to the promisor of his intention to do so.***

From section 56(3) of the Act, it briefly explain that when a party to the contract cannot perform his promise within the stipulated time, the innocent party may either terminate the contract or to treat it as still subsisting. If the innocent party choose to treat the contract as still subsisting, either expressly or by conduct, the contract will continue to exist but the time cease to be of the essence and becomes at large. Consequently, the innocent party will lose their right to claim liquidated damages under the contract. The time can be revived to be of the essence if the innocent party serve a notice to the defaulting party before the time lapse. The notice include the intention of the innocent party to claim compensation due to the breach and setting a new date of completion. The issue here is whether the absence of a clause in the contract such as in PWD 203A (Rev. 10/83) requiring the employer to issued notice, does section 56(3) of the Contract Act 1950 serves as an implied terms and the failure to follow them can waive the employer's right to liquidated damages.

In *Sakinas Sdn Bhd v. Siew Yik Hau & Anor*<sup>18</sup> Abdul Aziz held that section 56(3) did not apply and that it was not necessary to give notice before a right to impose LAD charges arose under a LAD clause. The court in *Tunjang Wawasan Sdn. Bhd. v TNB Generation Bhd*<sup>19</sup> also held the same decision that where there is a liquidated damages clause section 56(3) does not apply.

However in *Mardale Pipes Plus Ltd v Malaysian International Trading Corp (Japan) Sdn Bhd* (ExxonMobil Exploration and Production Malaysia Inc, third party)<sup>20</sup> the defendant argue that the requirement to give notice of intention to claim liquidated damages as stated in section 56(3) of the Contract Act on the ground of the Act did not apply where there was an LAD clause in the contract. The court held that the failure to issue notice by the defendant had invalidate their right to claim LAD. In fact the LAD clause could only be invoked when a notice under section 56(3) of the Act had been properly given by the defendant.

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<sup>18</sup> [2002] 5 MLJ 497

<sup>19</sup> [2007] MLJU 362

<sup>20</sup> [2009] 5 MLJ 691



In *Jarvis Brent Ltd v. Rowlinson Construction Ltd*<sup>21</sup> a contractor challenge recovery of liquidated damages on grounds that the document actually received from the employer is not the notice of liquidated damages required under the contract.<sup>22</sup> So, what constitutes a notice? Since the clause did not specify what information should be included in the notice, there is argument regarding the issue.

## 1.2 Problem Statement

Although most of the standard form contain provision for liquidated damages, but the procedure and language in the clause is not similar. For example clause 40 (Damages for Non-completion) in PWD 203A (Rev. 10/83), there is no requirement to issue notice by the employer before claiming liquidated damages. While in clause 22.1 PAM 2006 only state that the employer need to inform the contractor in writing of the deduction of LAD. Although there is no requirement to issue notice in the contract, contractor argue that notice should be given before claiming liquidated damages pursuant to section 56(3) of Contract Act 1950 which states that at the time of the acceptance of late delivery, the innocent party need to issue notice to state their intention to claim damages. Question arises whether section 56(3) of Contract Act is an implied term and shall be followed by the contracting parties.

In the new version of PWD standard form of contract, government had made an amendment in clause 40 of PWD 203A (Rev. 2007) provides clearly express notice requirement in the clause. It states that the employer prior to the issuance of Certificate of Non-completion must issue notice of intention to claim liquidated damages to inform the contractor about the payment or deduction. However, the clause did not expressly state that notice is condition precedent to the said claim. It is

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<sup>21</sup> [1990] 6 Const LJ 292

<sup>22</sup> Ndekugri I. and Rycroft M. (2000). *The JCT 05 Standard Building Contract Law and Administration*. (2<sup>nd</sup> ed.) Oxford: Elsevier.

not clear whether notice is deemed as condition precedent before claiming liquidated damages.

The foregoing discussion brings us to several pertinent questions:

- 1) The status of notice if it is stated as condition precedent in the LAD provision?
- 2) If the provision stated the requirement to issue notice before claiming liquidated damages but without expressly stated as condition precedent, does it considered as condition precedent?
- 3) If the contract contains no express provision for notice of intention to claim liquidated damages, is it possible to impose general act into the contract in order to make notice as condition precedent?
- 4) What information should be included in the notice?

### **1.3 Previous Studies**

There is several research studies had been carried out concerning liquidated damages. Yong (2006) has done studies on “Liquidated and Ascertained Damages (LAD) and Requirement of Mitigation”. The objectives were to determine the requirement of mitigation and the extent of the employer’s duty to mitigate his losses when enforcing his right under the liquidated damages clause. From the research, it was found that an employer’s requirements to mitigate the losses is silent in standard forms of contract, but despite that, the employer is bound to comply with the requirements of mitigation in enforcing LAD by taking all reasonable steps or action in accordance with principles of mitigation.

Chia (2009) had tried to identify the enforceability of the liquidated damages provision in construction contract. The finding from the research found that the party suffered losses will need to prove when claiming for compensation and required to mitigate the losses before claim for damages. But there is an exceptions to contract of sale and purchase under the Housing Developers Regulation 1989. This contract also exempts the party from the need to issue notice of intention when claiming for damages.

Mohamad Noor (2008) studied on the legal status of the practice of provisional liquidated damaged (PLD) and identified the reasons and the effect of imposing PLD on contractors. It was found that the contractual provisions must be strictly adhered by the government in order to secure their right to liquidated damages. Furthermore, in Malaysia the provisions are subject to the statutory provisions under the Act.

#### **1.4 Objective of the Study**

The objective of study is to ascertain whether:

- 1) The issuance of notice is a condition precedence
- 2) If so, how it arise
  - Contract Act; or
  - Common Law
- 3) The implication of notice provision

### **1.5 Scope of the Study**

The approach adopted in this research is case law based. There are no limitations as for the court cases referred to in this study in terms of type of projects as long as the case is related to “liquidated ascertained damages” and “notice to claim LAD”. Types of contract involved include construction contracts (between employer and main contractor, and between main contractor and subcontractor) and contracts of sales of goods and land. The standard forms of contract that will be referred to are:

- a) Public Works Department (P.W.D) Form 203A (Rev. 10/83) & (Rev. 2007)
- b) Pertubuhan Arkitek Malaysia (PAM) (2nd Edition, 2006)
- c) Construction Industry Development Board (CIDB) Standard Form of Contract for Building Works (2000 Edition)
- d) The Institution of Engineers, Malaysia (IEM.ME 1/94 Form)
- e) Joint Contracts Tribunal (JCT) Standard building contract guide (SBC/G), (1998) & (2005b).

### **1.6 Significance of the Study**

Poor understanding of the requirement of notification or the lack of notice has led to disputes and disagreement amongst the various parties in construction contract. The purpose of this study is to give an insight into the issues regarding the notice as condition precedent to claim liquidated damages and the court reaction and its decision concerning the issue. It is hoped that the findings of this study will assist the players in the construction industry to understand the significance of the liquidated damages clause in their contract, plus understand the requirement to issue notice of

intention to claim liquidated damages and put their best effort to avoid disputes involving those issues.

## **1.7 Research Methodology**

Research process and method of approach is vital as guidelines in preparing the research so that the research could be done in an organized way to achieve the research objective. Basically, this research process comprise of five major stages, which involve identifying the research issue, literature review, data collection, research analysis, conclusion and recommendation.

### **Stage 1 – Development of Proposal**

#### **1.7.1 Identifying the Research Issue**

The initial stage involves the identification area of issues as well as formulating the research objective. First, the overview of the concept of this topic will be done through the initial literature review. The study issue arises from intensive reading of books, journals and articles which can be attained from the UTM library, Building Construction Information Centre (BCIC) and Resource Centre of Alam Bina (RC). Once research objective has been formulated, the scope and limitations for the research will be determined as well as the research title.

### 1.7.2 Literature Review

Collection of various documentation and literature regarding the study field is of most important in achieving the research objectives. Data will be collected mainly through documentary analysis. All collected data and information will be recorded systematically. Data will be collected mainly from Malayan Law Journal, Singapore Law Report, Building Law Report, Construction Law Report and other law journals. Data is collected by browsing through the LexisNexis legal database. Important and relevant cases will be collected and used for the analysis at the later stage. In addition, secondary data from books, article reports, seminar papers, newspapers and articles from the internet, is also useful for this research. All the relevant books will be obtained from the Universiti Teknologi Malaysia library and other public libraries.

### Stage 2 – Data & Information Collection

#### 1.7.3 Data Collection

At this stage, all the collected data, information, ideas, opinions and comments will be arranged and recorded systematically. Important and relevant cases is collected and use for the analysis at the later stage.

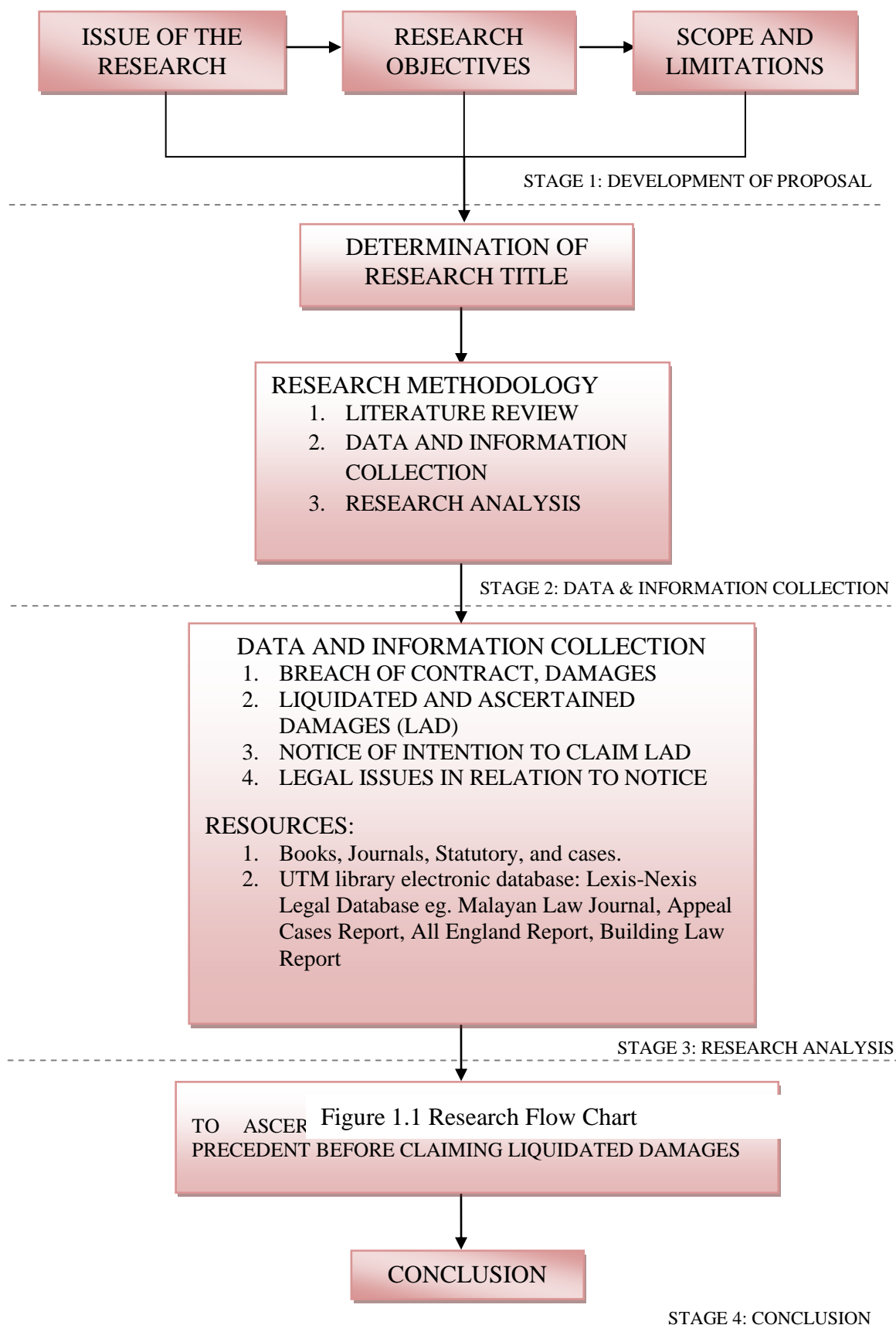
### Stage 3 – Analysis

#### 1.7.4 Research Analysis

The fourth stage of research is analysis phase. It involves data analysis, interpretation and data arrangement. Once the previous related court cases are collected, reviewing and clarifying all the facts of the cases will be conducted. The focus will be on the issue of this research. After identifying issues in each case, a thorough discussion and comparison will be done in order to achieve objectives of this study.

#### 1.7.5 Conclusion and Recommendation

In this final stage, discussions will be done based on the findings from the previous stage to fulfil the aims or objective of this research and reach a conclusion. Recommendations for further research will be made as a suggestion for future researcher.





## **1.8 Organization of the Thesis**

### **1.8.1 Chapter 1: Introduction**

The first chapter is an introduction to the research topic and covered a few subtopics. The first subtopic is background of the study, followed by problem statement which stated the issues that will be discuss in the study. Then, the next subtopic covered on the previous research on the similar topic; objectives of the research which stated the aims of the study; scope of the research; significance of the study and finally the research methodology that to be used during the process of research.

### **1.8.2 Chapter 2: Liquidated and Ascertained Damages (LAD)**

Briefly, this chapter will covered on definition of liquidated damages, issues concerned on LAD which include liquidated vs. penalty clause; the requirement to prove loss; the validity of LAD if the Architect/Engineer fails to grant a timely extension of time; can a party challenge the validity of a liquidated damages sum after the contract has been signed; and provisional liquidated ascertained damages.

### **1.8.3 Chapter 3: Provision of Liquidated Damages**

This chapter discuss on contractual procedure to claim liquidated damages. It is divided into five subtopics ie. Establish the default of the contractor; establish the existence and validity of the liquidated damages clause; determine if employer has waived his rights; determine whether the relevant certificates/notices have been issued; and employer recovers the liquidated damages. After that, the topic expend to discuss on liquidated damages provision in various standard forms for example in JKR 203A (Rev. 2007), PAM 2006, CIDB 2000 and etc; definition and purpose of notice; definition and court interpretation of condition precedent.

### **1.8.4 Chapter 4: The Status and Implication of Notice Provision**

This chapter is essential part of the research. Here, case law on condition precedent and notice requirement before claiming liquidated damages shall be analysed and the result discuss in a logical qualitative analysis. The task is to ascertain the status of notice provision in liquidated damages clause; whether it is condition precedent upon claiming liquidated damages.

### **1.8.5 Chapter 5: Conclusion and Recommendations**

This chapter is the final part of the whole report and is a conclusion chapter. Briefly, this chapter will give a detail summary of the research finding to a logical conclusion of the previous chapter, highlight the problem encountered during the course of the research and give recommendation on improving the subject area.

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